

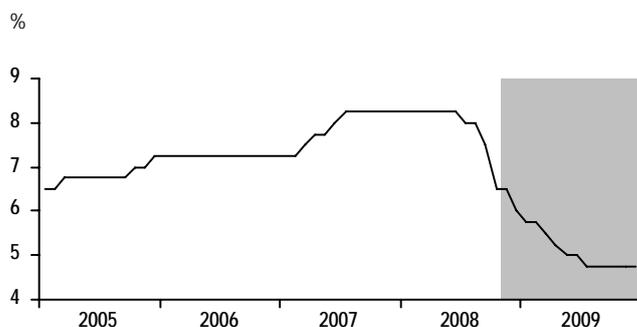
New Zealand Economic Update

RBNZ OCR announcement

- RBNZ cut OCR 100bp as expected
- OCR to be lowered further – to 4.75% by 3Q09 on our forecasts
- Fall in “stubbornly high” domestic price pressures RBNZ’s key focus

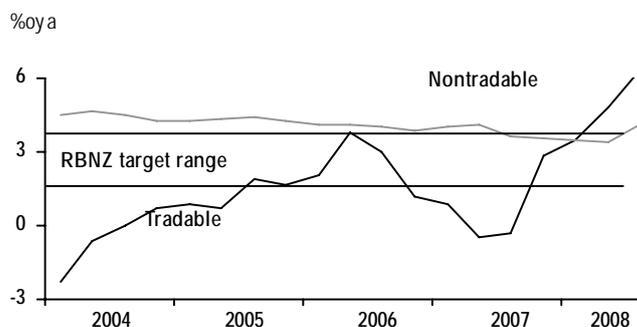
The RBNZ cut the official cash rate 100bp today (JPMorgan and consensus -100bp) to 6.5%. According to RBNZ Governor Alan Bollard, “ongoing financial market turmoil and a deteriorating outlook for global growth had played a large role in shaping” the decision.

New Zealand: RBNZ official cash rate



Medium term inflation is still the key point of focus for the RBNZ; officials expect to lower the OCR further if inflation evolves as projected. The Bank forecasts inflation to fall below the top end of its 1-3% target range by mid-2009. Dr. Bollard appears particularly concerned about non-tradables inflation, saying that “evidence of actual reductions in domestic cost pressures” will determine the timing and size of future adjustments to the OCR. Data on Monday showed that non-tradable inflation—generated domestically and not influenced by exchange rate fluctuations—surged to 4.1%oya, up sharply from 3.4% in 2Q, and well above the RBNZ’s comfort zone. We had expected that non-tradable inflation would ease in the third quarter, in line with the significant slowdown in the domestic economy.

New Zealand: nontradable and tradable inflation



In our view, the onset of financial market instability and accumulating downside risks to global economic growth point to even more significant policy easing from the RBNZ. Two quarters of declining GDP in 1H08 mean the New Zealand economy already has endured a technical recession. We forecast another three quarters of falling GDP. Private consumption, in particular, which accounts for nearly two-thirds of the economy, is facing considerable headwinds. Consumers remain under significant pressure from still-high interest rates, a softening labour market, and the rapidly deteriorating housing market. Furthermore, credit availability has declined. That said, the RBNZ believes that the “reduction in domestic spending will be partly offset by the depreciation of the New Zealand dollar”, along with “falling oil prices and the recent loosening of fiscal policy.”

The problematic global economic and financial market outlook, sagging domestic house prices, the falling terms of trade, and the improving prospect that inflation will return to the RBNZ’s target range over time provides ample scope for the RBNZ to ease monetary policy assertively. We maintain our forecast that the next move in the OCR will be a 50bp cut in December. There is no scheduled policy meeting in November. Importantly, in the press conference following today’s OCR announcement, Dr. Bollard announced that future rate cuts would not necessarily be of this size (referring to today’s 100bp move). Our forecast calls for an OCR of 4.75% by end-2009.

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